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No. 91-1513

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE,
ASSISTANT COMMISSIONER, PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

On Writ of Certiorari to the
United States Court of Appeals
For the Sixth Circuit

BRIEF FOR THE AMICUS CURIAE
BUREAU OF INSURANCE, COMMONWEALTH OF VIRGINIA
DEPARTMENT OF INSURANCE, STATE OF NORTH DAKOTA

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STATEMENT OF STANDING

The Bureau of Insurance of the State Corporation Commission of The Commonwealth of Virginia and the Department of Insurance of the State of North Dakota, as *amicus curiae*, have obtained the consent of both the Petitioner and the Respondent to submit this brief. The letters of consent have been lodged with the Clerk of the Court.

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Introduction

While it may be framed in a variety of different ways, the issue presented to this Honorable Court is fundamentally the following: in this age of larger and more frequent insurer insolvencies, to what extent will state regulators be able to rely upon the protection afforded to them by Congress in the *McCarran-Ferguson Act* in their quest to fully protect the insurance buying public from the ravages of the industry's mismanagement and misfortune? In 1945 Congress determined that, with the exception of the antitrust laws, the states' exercise of their police power in assuring that insurance consumers would be able to realize the contractual benefits for which they had paid should remain unfettered by the unintended application of the plethora of federal laws governing interstate commerce. This case presents the Court the opportunity to resolve unequivocally whether the intent of Congress to permit the several states to protect their citizenry in the insurance world may be frustrated by hyper-technical erosions on the application of this all-important statute.

Insurance plays a significant role in the smooth operation of commerce, industry and the everyday lives of Americans. There is little doubt that often it is the means by which businesses can continue to exist, and people can plan for their future. With the growing prominence and reliance on insurance, there has been a proportionate rise in the problems experienced with insurance companies. It has been the traditional role of the states to regulate the affairs of the insurance industry in order to protect the interests of the policyholders who rely on the insurance company for so much. This role should not be undermined by the application of the federal priority statute as advocated by the Petitioner.

Summary of Argument

1. As is reflected in 15 U.S.C. §§ 1011 and 1012, Congress intended that the regulation of the insurance industry be left in the hands of the states. Under Section 1011, the business of insurance and every person engaged in it are subject to state regulation and, under Section 1012, no federal law (other than anti-trust laws) shall take precedence over such state regulation unless it is specifically directed at insurance. The scope of state regulation is over the entire industry, not merely the insurance policy.

2. The liquidation of an insurance company, including the scheme by which its assets are distributed, is part of the state's regulation of insurance. Accordingly, the Ohio liquidation statute, including that portion dealing with the order in which claimants receive distributions, and not the federal priority statute, which is not specifically directed toward insurance, governs the relative rank of creditors in the allocation of the insolvent insurer's assets. Application of this Court's test as announced in *Royal Drug* and in *Pireno* to reach a contrary result raises a specter of unnecessary clash between the will of Congress as manifested in the Act and this Court's well reasoned application of that statute's expressed retention of federal anti-trust jurisdiction over insurers.

3. Because of its unique nature, insurer liquidation is, and should be, exempted from the *Federal Priority Statute*, as are bankruptcy proceedings. But for the exception the Bankruptcy Code makes for them, insurers would be debtors and outside the scope of the *Federal Priority Statute*. Congress has left the liquidation of insurance companies to the states, not for the reason that it desires that the federal government receive priority payments, but because the states are in the best position to administer the estates in the interest of all claimants.

4. The state scheme of regulation for insurance companies, while designed to protect the interest of policyholders, also serves the interests of other claimants to the estates, and does so in an orderly fashion. In a properly administered estate, there is no rational basis for giving precedence to the federal government. Priority, if any, is properly placed according to the comprehensive state regulatory scheme, so long as it does not discriminate against interests similarly situated. Since that is the case with the Ohio statute, the ruling of the Court of Appeals for the Sixth Circuit is well reasoned, is consonant with the intent of Congress and the applicable decisions of this Honorable Court, and should be affirmed.

Argument

A. The *McCarran-Ferguson Act* Gives Broad Power To The States To Regulate The "Business of Insurance"

The *McCarran-Ferguson Act* was passed in response to the ruling in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). *South-Eastern Underwriters*, for the first time, allowed partial federal regulation of insurance companies. Before *South-Eastern Underwriters*, insurance transactions were not considered to be part of interstate commerce and, thus, were beyond federal regulation. *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868). While *Paul* focused on the broad question of the right of the states or the federal government to regulate insurance, *South-Eastern Underwriters* had a more narrow focus, addressing the application of federal antitrust laws to the insurance industry. Fearful that the *South-Eastern Underwriters* decision would eliminate the regulatory power states had over the insurance industry, Congress passed the *McCarran-Ferguson Act*, 15 U.S.C.A. §§ 1011-15 (West 1976) (the *Act*).

The House of Representatives, after oral argument in *South-Eastern Underwriters*, but before this Court announced its opinion, passed a bill exempting the insurance business from federal antitrust laws. *See* 90 Cong. Rec. 6565 (1944). This first bill was, however, killed in the Senate. *See id.* at 8054. Nevertheless, early the next year, as a reaction to the threat of increasing federal regulation over the insurance business, and to resolve the

crisis created among the several states in reference to the regulation and taxation of the insurance industry, Congress again turned its attention to the issue of regulation of the insurance industry and the Act was the result. *See* Act of March 6, 1945, ch. 20, § 1, 59 Stat. 33 (codified at 15 U.S.C. §§ 1011-1015).

A bill was introduced in the Senate on January 18, 1945. *See* Journal Of The Senate 40 (1945). A similar bill, after being introduced in the House, was tabled. *See* 91 Cong. Rec. 1094 (1945). Senate Bill 340, entitled "A bill to express the intent of the Congress with reference to the regulation of the business of insurance," was reported on a week later, January 25, 1945. *See* 91 Cong. Rec. 478 (1945). The two houses disagreed in regards to an amendment to the bill, and as a result, the bill was directed to a conference committee.

The point of contention between the House and Senate which necessitated sending the bill to conference concerned an amendment by Senator Ferguson, making the Sherman and Clayton Acts applicable to the states in the area of insurance. *See* 91 Cong. Rec. 1480 (1945). The House disagreed with Senator Ferguson's amendment. *See* 91 Cong. Rec. 1481 (1945).

The subsequent conference report was a compromise which made the Sherman and Clayton Acts applicable to the states "to the extent that such business is not regulated by state law." *See* 15 U.S.C.A. § 1012(b). The conference report, then, had the effect of reaching an agreeable compromise whereby state legislatures were precluded from authorizing violation of the Sherman and Clayton Acts with respect to boycott, coercion, or intimidation. *See* 15 U.S.C.A. § 1013; 91 Cong. Rec. 1487 (1945). This compromise serves as an indication that Congress did mean what it said in the language of the Act; namely, that federal law is pre-emptive of state law in the insurance area only where the state statutory scheme is silent regarding a matter which Congress has passed a general piece of legislation covering, or where Congress has passed legislation specifically relating to the business of insurance. *See* 15 U.S.C.A. §§ 1011-1012. Read conjunctively, no other result can flow from the first two sections of the

Act. Moreover, in light of the disagreement between the two houses regarding the application of federal antitrust laws, and especially considering that the Act's third section provided for a three year moratorium on the application of certain federal laws, no other result can obtain. *See* 15 U.S.C.A. §§ 1011-1013. That is, the Act contemplates, and the compromise resulting from the conference report confirms, that the Act had a dual purpose: (1) to meet the crisis created by the *South-Eastern Underwriters* decision head-on and thereby effectuate an immediate remedy for the insurance industry (thus the moratorium in § 1013); and (2) to provide a long range scheme whereby the states would continue their traditional control over all aspects of the insurance industry (thus the broad language in §§ 1011-1012).

Congress intended to *restore* the control of the insurance industry to the states. *See* 91 Cong. Rec. 485 (1945). Congress was trying to make it clear to the states that the federal government was removing itself "as far as possible" from the regulation of the insurance industry. *See id.* at 1090. As such, the underlying notion that the regulation of the insurance industry should be under state auspices is the linchpin of speeches presented during Congressional debate. *E.g., id.* at 1482. Indeed, the "important thing" in the bill was said to be "that it [the bill] would put the regulation of the insurance business in the hands of the States." *Id.* at 487.

To accomplish this result, the Act was designed to be applicable to federal statutes then in existence and to federal statutes enacted after the Act's effective date which do not specifically relate to insurance. *See id.* at 479. It would be accurate to say, therefore, that the intent of Congress was to allow the states to "do the various other things [besides issue permits and collect taxes] which are necessary to be done" in the regulation of the insurance industry, and to "function freely" in handling such matters. *See id.* at 483.

The intent of Congress has been recognized by the Courts. They have stated that the dominant purpose of Congress in passing the Act was to give broad support to existing and future

state systems for regulating and taxing the business of insurance. *See, e.g., Securities Exch. Commn. v. National Sec., Inc.*, 393 U.S. 453 (1969); *Wilburn Boat Co. v. Fireman's Fund Ins. Co.*, 348 U.S. 310 (1955); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946); *Allstate Ins. Co. v. Lanier*, 361 F.2d 870 (4th Cir.), *cert. denied*, 385 U.S. 930 (1966). Thus, the Act reveals Congressional intent that states should *continue* regulating the insurance business where Congress has not expressly pre-empted the subject. *See Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n.*, 332 U.S. 507 (1947). Inasmuch as the Act intended to return the primary responsibility for insurance regulation to the states, only when the state has not acted will federal legislation become effective as to the area of insurance. *See Monarch Life Ins. Co. v. Loyal Protective Life Ins. Co.*, 326 F.2d 841 (2d Cir. 1963), *cert. denied*, 376 U.S. 952 (1964).

The exemption from federal control provided for under the Act applies to any area covered by state insurance laws; thus, the areas of regulation reserved for state control are determined not by the area's nature or importance but by whether a state has chosen to occupy it. *See Lawyers Realty Corp. v. Peninsula Title Ins. Co.*, 428 F. Supp. 1288 (E.D. La. 1977), *aff'd*, 550 F.2d 1035 (5th Cir. 1977). The proper test in interpreting the Act's parameters is to inquire whether the federal statute sought to be applied invalidates a state law regulating the practice of insurance. *See Miller v. National Fidelity Life Ins. Co.*, 588 F.2d 185 (5th Cir. 1979). Where, therefore, a state has authorized certain standards of conduct by setting forth a comprehensive scheme for regulating the insurance industry, the state scheme pre-empts general federal legislation. *See Ohio AFL-CIO v. Ins. Rating Bd.*, 451 F.2d 1178 (6th Cir. 1971). The Act thereby allows state regulatory schemes to proscribe, permit, or otherwise regulate insurance activities which but for the Act would violate federal laws. *See Seasongood v. K & K Ins. Agency*, 548 F.2d 729 (8th Cir. 1977).

Clearly, Congress was interested in preserving state regulation over the insurance industry, and its myriad issues; not just some limited aspect of it, like the insurance policy. This intent is

clearly articulated in § 1011 of the Act (Amicus Appendix 1a). When read in the context of the events leading to its enactment, the scope of the Act is not so limited as advocated by Petitioner. Accordingly, it is quite apparent that by passing the Act, Congress intended to keep traditional state-regulation of the insurance industry outside the realm of federal regulation. Congress did not intend to limit state regulation to the issuance of the insurance policy. Rather, the scope of exclusive state regulation deliberately extended to the entirety of the insurance industry, in recognition of the fact that such regulation, from cradle to grave, must be comprehensive in order to effectuate the states' police power in protecting policyholders.

The insurance industry involves a vital public interest and its regulation is not just a matter of public policy, but is in fact, a matter which rests firmly within the police power of the several states. *See, e.g., California State Auto. Assoc. Inter-Insurance Bureau v. Maloney*, 341 U.S. 105, 109-110 (1951); *Ozborn v. Oslin*, 310 U.S. 53, 65 (1940); *German Alliance Ins. Co. v. Hale*, 219 U.S. 307, 316-17 (1911). Insurance receiverships are key elements of this police power exercised for the protection of the insurance buying public and providing for the stability of the insurance system as a whole. *See, e.g., Baldwin-United Corp. v. Garner*, 678 S.W.2d 754 (Ark. 1984), *cert. denied*, 471 U.S. 1111 (1985); *Carpenter v. Pac. Mut. Life Ins. Co.*, 74 P.2d 761 (Cal. 1937), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938). The states are able to ensure equitable treatment for creditors and avoid preferences upon the liquidation of an insurer by providing that any matter affecting the assets available for distribution be the subject of a single integrated administration. *Eden Financial Group, Inc. v. Fidelity Bankers Life Ins. Co.*, 778 F. Supp. 278 (E.D. Va. 1991); *Knickerbocker Agency, Inc. v. Holz*, 4 A.D.2d 71, 73, 162 N.Y.S.2d 822 (N.Y.A.D. 1957), *aff'd*, 149 N.E.2d 885 (N.Y. 1958); *see also Schacht v. Brown*, 711 F.2d 1343 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983) (the policy underlying the statutory liquidation process is "the protection of the interests of policyholders, shareholders and creditors jointly" by the receiver); *Metropolitan Life Ins. Co. v. Board of Directors of Wisconsin Ins.*

Sec. Fund, 572 F. Supp. 460 (W.D. Wis. 1983); *Consumers Super Market No. 2, Inc. v. Underwriters at Lloyds*, 189 So. 2d 648 (Fla. Dist. Ct. App. 1966).

Both the plain language of the Act and its legislative history support the conclusion that, except as to antitrust matters, the states are to regulate the insurance industry without interference from the federal government, with the exception of antitrust matters, until such time as Congress expressly directs otherwise. In short, the regulation of insurance is, by operation of *McCarran-Ferguson*, left exclusively to the states except with respect to:

(1) federal statutes specifically relating to the business of insurance; and

(2) the Sherman Act, the Clayton Act and the FTC Act.

No argument is advanced (and none could be sustained) that the *Federal Priority Statute* is either specifically related to the business of insurance or part of these antitrust statutes. Accordingly, if the Ohio statute in issue is part of Ohio's regulation of insurance, it controls over the *Federal Priority Statute*.

B. The Liquidation Of An Insurance Company Is The "Business Of Insurance"

Conflicts between the attempted application of federal non-insurance statutes to troubled or insolvent insurers and the exclusive regulation of the insurance industry by the states are much in vogue and, in the main, focus on the definition of "business of insurance". This is because the argument is often advanced that Congress has left to the exclusive regulation of the states only the "business of insurance" and that much of what is involved in the rehabilitation or liquidation of insurers does not fall within that universe. In support of these inroads into state regulation of the industry, torturous and hyper-technical analyses are made seeking to carve out a narrow subset of the activities in which insurers engage as constituting the "business of insurance", placing all other activities of the industry in a

broader universe alleged to fall outside the province of exclusive state regulation. While, in some respects, intellectually appealing, this approach is misguided and flies in the face of the public policy underlying the *McCarran-Ferguson Act* and this Honorable Court's decisions on point. This Court has long understood exactly what Congress left to the states in 1945 and, when fairly read, its decisions cannot be reasonably interpreted as contrary to that understanding.

1. The *National Securities* Test

Notwithstanding the plain language of the statute, and its legislative history, as both Petitioner and Respondent point out, there has been substantial debate about the meaning of the "business of insurance". In attempting to reach a resolution of the issue, this Court has applied different tests to the two parts of § 1012 (Amicus Appendix 1a). For the first part, this Court has prescribed a broad test to give to states the intended regulatory exclusivity, consonant with the sense of Congress, that insurance is better addressed by the states, rather than the nation. For the antitrust exemption, the second part of § 1012, a narrower test is expressed to give limited state immunity from federal antitrust laws, and further the nation's undisputed interest in regulating interstate commerce.

The Court articulated the test for the first part of § 1012 in *Securities Exch. Commn. v. National Sec., Inc.*, 393 U.S. 453 (1969). The Court stated that to qualify as the "business of insurance" an activity must either directly or indirectly affect the relationship between the insurer and the insured. *Id.* at 460 At the core of this relationship is the type of policy which is issued, its reliability, interpretation, and enforcement. *Id.* Additionally, other activities of insurance companies which relate closely to their status as reliable insurers are the "business of insurance." "[W]hatever the exact scope of the statutory term, it is clear where the focus was — it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance." *Id.* Clearly, then, a

liquidation proceeding must be the "business of insurance", as it is the final step in a state's efforts to protect the interest of the policyholder. In a liquidation proceeding, the relationship between the policyholder and the insurance company is of paramount importance. The very purpose of the liquidation scheme is to fulfill the obligations of the insolvent insurance company to its policyholders by providing for the adjustment and payment of claims in a prescribed order. Because most insolvent companies will not have sufficient assets to satisfy all creditors, the order of distribution is crucial.

Ensuring satisfaction of policy obligations is directly related to the reliability and enforcement of the insurance contract. Accordingly, the priority statutes are a fundamental component of an insurance company's reliability, and a mechanism upon which insureds can rely in their purchase of insurance products. The state does not create an arbitrary system of payment. Rather, the order of distribution in liquidation is analogous to the payments the company makes while viable: obligations to policyholders are first, followed by the other obligations of the company. Nothing within Petitioner's argument suggests otherwise, or that it should be otherwise. Thus, in many respects, the allocation of an insurer's assets in state liquidation proceedings seeks to fulfill the contractual undertakings on the strength of which it obtained such assets in the first place, i.e., its policy obligations. To that extent, therefore, the liquidation proceeding does nothing more than continue the substance of the relationship between the insurer and its insured, seeking as much as possible to "honor their bargain". Neither prudence nor logic supports the position that insurance companies should set aside special reserves for any liability that might be asserted by the federal government, as would in fact be required if the law were what Petitioners suggest it should be. This is especially so in the present context, where, at best, the federal government is no more than the beneficiary of an insurance policy. This is not to suggest that obligations to the federal government are not important — they are. But in the context of insurance regulation, they are no more compelling than obligations to policyholders.

Any other result leads only to chaos and unexpected and unanticipated artificial influences in the open market. [1]

The liquidation proceeding necessarily implicates the transfer or spreading of a policyholder's risk and is an integral part of the relationship between insurer and insured. The liquidation of an insurer is directed at maximizing the interests of its policyholders and is a key element of a state's regulation of the business of insurance. The Petitioner's simplification of liquidation notwithstanding, in order for the Court to find that a liquidation is not the "business of insurance," it must ignore this pivotal relationship and its risk-spreading character. State laws protecting or regulating the relationship between the insurance company and the policyholder, either directly or indirectly, such as laws providing for the rehabilitation, liquidation or dissolution of insurers, are "laws regulating the business of insurance." *E.g.*, *Washburn v. Corcoran*, 643 F. Supp. 554, 556 (S.D.N.Y. 1986).

The Sixth Circuit correctly found that:

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[1] If the law clearly established a super priority for the federal government in the allocation of assets upon rehabilitation or liquidation of an insurer, insurers which marketed their coverages to federal agencies would, of necessity, become less attractive to commercial insureds. That is so because such insureds would recognize that if the carrier became insolvent, their claims against its assets would be subordinate to those of the federal government. And note further that the proposition that this issue applies to entities eligible for bankruptcy relief and not to insurers (which unquestionably are not so eligible) might lead to further surprising results. Thus, health maintenance organizations are, at least arguably, eligible for bankruptcy relief. *See, e.g.*, *In re Family Health Services*, 101 B.R. 618 (Bankr. C.D. Cal. 1989). Buyers of health care coverage might choose to obtain such protection from HMOs in the belief that upon the financial demise of such an entity their claims against the assets would not be inferior to those of the federal government since the federal priority act does not apply to bankruptcy proceedings. By contrast, if they were to obtain such coverage from indemnity health insurers, such buyers could expect their claims against the entity (if it were to become insolvent) to be inferior to those of the federal government. And while most insureds do not anticipate that their carrier will become insolvent, the frequency with which that has occurred in recent times has led most sophisticated purchasers to plan for that as a potential contingency.

> *[The State's priority statute] is designed to support and undergird the entire contractual process between insurer and insured, as implicitly recognized by the parties, by transferring the risk of insolvency immediately upon contracting. Just as the regulatory scheme of the Federal Depositor Insurance Corporation regulates the business of banking for the protection of depositors, [the priority statute] regulates the business of insurance for the protection of policy holders.*

Fabe v. United States Dept. of Treasury, 939 F.2d 341, 351 (6th Cir. 1991).

Further, and contrary to Petitioner's assertion, an insolvent insurance company does not "cease to exist" nor does the relationship between the insurer and insured "terminate." *Petitioner's Brief at 8.* An insolvent insurer usually does not forfeit its charter until the liquidation is complete. More importantly, the insurance relationship does not cease to exist simply because a state insurance commissioner is now performing the duties of the insurer. The Commissioner must continue to adjust and pay claims of the policyholders[2] which arise out of the insurance contract — the very source of the insurance relationship. The fact that a Commissioner administering an insurance liquidation generally does not create new insurance relationships with new policyholders has no bearing on the existing contracts. By Petitioner's own admission, "a liquidator may continue to engage in aspects of the business of insurance during the liquidation . . . " *Petitioner's Brief at 15 n.5.*

It is nothing short of the epitome of sophistry to pretend that financial deterioration of an insurer (over which its customers have no control) fundamentally changes *the relationship* between it and its insureds so that the latter may no longer realize the full benefits of the regulatory scheme under which the carrier operated in the first instance. There can be little doubt

[2] *See, e.g., Ohio Rev. Code Ann.* § 3903.42 (Page 1989).

that those insureds continue, even in insolvency, to rely upon the company to provide indemnification and other insurance coverages. That the company may no longer be capable of fulfilling its contractual obligations in the way in which it had promised in no way diminishes its customers' reliance on precisely that coverage. That the individual states seek to replace the company's pre-insolvency ability to fulfill such obligations with statutory constructs designed to provide reasonable substitutes should in no manner justify the interposition of a new set of legal constraints the effect of which is to undermine the ability of the states to deliver the intended protection.

Most telling about the Petitioner's position, though, is the fact that the insurance company cannot start a proceeding in the bankruptcy court. It is still an insurance company, even though in liquidation, and beyond the scope of the federal bankruptcy laws. 11 U.S.C.A. § 109(b)(2) and (d); *In re Union Guarantee & Mortgage Co.*, 75 F.2d 984, 985 (2d Cir.), *cert. denied*, 296 U.S. 594 (1935); *In re Peoria Life Ins. Co.*, 75 F.2d 777, 778 (7th Cir.), *cert. denied*, 296 U.S. 594 (1935); *In re Equity Funding Corp. of America*, 396 F. Supp. 1266, 1275 (C.D. Cal. 1975); *In re National Surety Co.*, 7 F. Supp. 959, 961 (N.D.N.Y. 1934). If Petitioner's position were true, that this is a mere corporation distributing its limited assets, there would not need to be that exemption from the bankruptcy laws; yet such exemption remains. The significance of this exemption is not merely in its existence, but in the implication it has for Petitioner's core argument. If the insurance company in liquidation is nothing more than any other company, and should be in bankruptcy, then the federal priority statute would not apply, and Petitioner would have no case to argue today.[3]

[3] The federal priority statute does not apply in proceedings under the federal bankruptcy code. See Act of Nov. 6, 1978, Pub. L. No. 95-598, § 322(a), 92 Stat. 2678 (codified at 31 U.S.C.A. § 3713 (2)).

The federal priority statute was removed from application to bankruptcy proceedings because it did not generate any meaningful recovery to the government, and because the federal government, for the most part, was pursuing contractual claims for which it should receive no greater treatment than other creditors. Further, there was a recognition of the fact that the federal government was better able to bear the loss, since it could distribute it among all taxpayers, than other creditors who bear the brunt of their own loss.[4] This reasoning was recognized almost 70 years ago:

> *No sound principle of public policy can be invoked in support of preference to the federal government and to the states over citizens in the collection of ordinary debts. On the contrary, the contractual operations of the federal government and of the states have become so extensive and so involved with the business of private citizens that priority to the federal government and to the states, except for taxes, would operate as an oppressive hardship on other creditors of bankrupts.*

Davis v. Pringle, 1 F.2d 860, 864 (4th Cir. 1924), *aff'd*, 268 U.S. 315 (1925).

Noticeably absent from Petitioner's brief is any explanation why the liquidation proceeding of an insurance company should receive less dignity than a bankruptcy proceeding of a non-insurance company. The immediate answer is that there is no logical reason for excluding the priority statute from bankruptcy application, but not analogous liquidation proceedings in a state court. Indeed, the reason for not applying the priority

[4] *See Communication from the Executive Director*, Commission on the Bankruptcy Laws of the United States, House Doc. no. 93-137, Part 1, p. 216-218, July 1973; *Proposed Legislation and Recent Developments on Lien Priorities*, 4 Real Prop., Prob. & Trust J. 413, 414-415 (Spring 1969); *Report of the ABA Ad Hoc Committee To Study the Federal Priority in Insolvency*, 21 Real Prop., Prob. & Trust J. 673 (1986).

statute in the context of an insurance company liquidation is more compelling than in the bankruptcy context. Policyholders have given their money in trust to the insurance company to protect against certain assumed risks, knowing that even if the company fails, the trust funds will still be accorded the dignity of the trust *res* to the extent possible.

The reasoning behind this "hands off" approach to insurance insolvency by federal bankruptcy courts was clearly articulated by the Fourth Circuit Court of Appeals in *Sims v. Fidelity Assur. Ass'n.*, 129 F.2d 442 (4th Cir. 1942), *aff'd on other grounds*, 318 U.S. 608 (1943). In speaking of the exception of insurance companies from bankruptcy protection, the 4th Circuit stated:

> *[R]easons for making these exceptions may be surmised to lie in the public or quasi-public nature of the business, involving other interests than those of creditors, in the desirability of unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs.*
>
> *All states, probably, have in fact regulated insurance companies of all kinds, and provided for their liquidation. The affairs of an embarrassed or insolvent insurance company often require much technical skill and judgment and time for their adjustment and a carrying forward of the business, to prevent lapses and to permit reinsurance to simplify them (quoting In re Supreme Lodge of the Masons Annuity, 286 F. 180, 184 (D.C. Ga. 1923)).*
>
> . . .
>
> *It was considered that it would be a ruinous thing to the state, to the depositors, and to the creditors to have the elaborate scheme of liquidation which the state provides broken into and*

> *nullified by bankruptcy proceedings, and it was intended by withdrawing jurisdiction over these corporations from the bankruptcy court, that this would not occur (quoting Woolsey v. Security Trust Co., 74 F.2d 334, 337 (5th Cir. 1934)).*
>
> . . .
>
> *The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise.*

Id. at 448-49.

Little logic can be found in an argument that Congress determined to permit the states to effect regulatory protection for the purchasers of insurance but that such protection should be so construed as to confer upon the creditors of companies so regulated a status inferior to that of creditors of business enterprises whose demise is governed by federal bankruptcy laws. Indeed, there is no logical reason for excluding the priority statute from bankruptcy application, but not analogous liquidation proceedings.[5]

[5] The Petitioner notes the fact that the federal priority statute does not apply in the bankruptcy context, and concludes from the enactment of that clarification in 1978, and the revision of the federal priority statute in 1982 that Congress did not intend for there to be any waiver of the priority in the non-bankruptcy context. *Petitioner's Brief at 10-11 n.3.* This is a non-sequitur on the part of Petitioner. Having specifically provided in the Act that non-specific federal laws would not preempt the state regulation of insurance, it was not for Congress to reaffirm this position. Rather, in the absence of any modification of the federal priority statute, Congress must have intended that it not apply to insurance company liquidations.

Recognizing this long-standing federal deference to state regulation, the *National Securities* test envisions a result whereby the liquidation of the insurance companies is included within the integrity of state regulation of insurance, and therefore, beyond the application of the federal priority statute, since it is not specifically directed toward the regulation of insurance.

2. *The Royal Drug-Pireno Test*

a. The *Royal Drug* and *Pireno* Definitions of the Business of Insurance have been applied so as to frustrate Congressional Intent

Subsequent to *National Securities,* this Court articulated and refined a test for the meaning of the "business of insurance" in the antitrust context. *Group Life & Health Insurance Co. v. Royal Drug,* 440 U.S. 205 (1979), *cert. denied,* 469 U.S. 1160 (1985), and *Union Labor Life Ins. Co. v. Pireno,* 458 U.S. 119 (1982) (the *Royal Drug-Pireno test*). This test is a three part inquiry: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno,* 458 U.S. at 129.[6]

The *Royal Drug-Pireno* test is quite different from the *National Securities* test. It has been interpreted to include only "horizontal" transactions or those between the insurer and the insured. As noted by the dissent in *Royal Drug,* this test excludes from state regulation provider agreements, advertising agreements, agreements between insurers (such as cooperative ratemaking and pooling of loss data) and the peer review process, among other activities, because the only parties involved in these activities are insurance companies and third parties — not policyholders. *Royal Drug,* 440 U.S. at 243-246 (Brennan, J.,

[6] There is some question whether one or all three components of the inquiry must be satisfied. *Gordon v. United States Dept. of Treasury,* 846 F.2d 272 (4th Cir.), *cert. denied,* 488 U.S. 954 (1988). That issue does not need to be decided here, though, since all three elements are met.

dissenting); *see also Pireno*, 458 U.S. at 136 (Rehnquist, J., dissenting). Extending this result so as to restrict the state's regulatory authority outside the context of antitrust disputes is contrary to Congress' intent. Some provider agreements must necessarily be made to provide insureds with the bargained-for benefits. This directly affects the relationship between the insurer and the insured. Additionally, agreements between two or more insurers or insurers and certain third-parties directly affect the cost to the insured. Both this Court and Congress have recognized these activities as within the scope of the Act. *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958) (insurance advertisement); 91 Cong. Rec. 1481, 1484 (1945) (cooperative ratemaking agreements); 90 Cong. Rec. 6538 (1944) (other vertical agreements). State regulation of these activities is a vital component of the states' regulation of insurance and should not be excluded in a misguided expansion of a reasonable application of congressional intent that insurers not be shielded from the application of certain federal antitrust laws. The states, being on the front line of insurance regulation, are best suited to this regulatory effort, as has been historically recognized.

b. *Royal Drug* And *Pireno* Are Irrelevant To Liquidation Proceedings

Even if this Court finds that the *Royal Drug-Pireno* test accurately reflects Congressional intent, the holding of the Sixth Circuit must still be affirmed. The *Royal Drug-Pireno* test is limited to the antitrust exemption, which is not implicated in this case. As stated by the *Royal Drug* court:

> *The primary concern of Congress . . . was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance. This concern is reflected in §§ 1 and 2(a) of the Act, neither of which is involved in this case. A secondary concern was the applicability of the antitrust laws to the insurance industry.*

> *The question in the present case . . . is one under the quite different secondary purpose of the McCarran-Ferguson Act to give insurance companies only a limited exemption from the antitrust laws. The repeated insistence in the dissenting opinion that the McCarran-Ferguson Act should be read as protecting the right of the States to regulate what they traditionally regulated is thus entirely correct — and entirely irrelevant to the issue now before the Court . . . for the question here is not whether the McCarran-Ferguson Act made state regulation of these Pharmacy Agreements exempt from attack under the Commerce Clause. It is the quite different question whether the Pharmacy Agreements are exempt from the antitrust laws.*
>
> *In short, the McCarran-Ferguson Act freed the States to continue to regulate and tax the business of insurance companies, in spite of the Commerce Clause. It did not, however, exempt the business of insurance companies from the antitrust laws.*

Royal Drug, 440 U.S. at 217-18 & n.18.

Likewise, in *Pireno*, another antitrust case, Justice Brennan recognized that the Court's opinion was applicable only to the narrow antitrust exemption. Thus, he stated, "the question before us is controlled by *Royal Drug* . . . *Royal Drug* identified three criteria relevant in determining whether a particular practice is part of the 'business of insurance' exempted from the *antitrust laws.*" *Pireno*, 458 U.S. at 126, 129. It is significant that the Court held that *Pireno* was not controlled by *National Securities* because the Court was construing the antitrust exemption of the *Act* and not the general preemption given to States in other insurance matters. In fact, *National Securities* was mentioned

only twice in the majority opinion, both times indirectly.[7] Significantly, *Pireno* distinguished itself from those cases involving claims adjustment:

> *The premise of the dissent is that NYSCA's Peer Review Committee actually constitutes "the claims adjustor" in this case . . . from this premise the dissent reasons that since "claims adjustment is part and parcel of the "business of insurance" protected by the McCarran-Ferguson Act," . . . it necessarily follows that the peer review practices at issue in this case must enjoy the Act's exemption. The fatal flaw in this syllogism is that NYSCA's Peer Review Committee is not the claims adjustor.*

Pireno, 458 U.S. at 134 n.8. The claim adjustment process is not materially different from the liquidation of policyholder accounts. The liquidator in the case before the Court today *is* the claims adjustor. Thus, by the explicit holding in *Pireno,* the liquidation proceeding is "part and parcel of the 'business of insurance' protected by the *McCarran-Ferguson Act.*" *Pireno* 458 U.S. at 134 n.8.

Petitioner asks this Court to apply *Royal Drug* and *Pireno* to the matter at hand.[8] However, for this Court to find that the *Royal Drug-Pireno* test should be interpreted to exclude from the

[7] The first time is on page 131 where the *Pireno* court quotes *Royal Drug* quoting *National Securities*. The second time is at page 133 quoting Petitioner's Brief quoting *National Securities.*

[8] In fact, Petitioner would have the Court apply a new and more stringent test of its own creation, that a State regulation must be "integral to the contractual relationship between the insurance company and the insured . . . and [to] whether the policyholder has a valid contractual claim against the insurer." *Petitioner's Brief* at p. 19-20. This test not only ignores the historical context of insurance regulation, but it also engages in aggressive revisionist rewriting in an unfounded attempt to further federal regulatory expansionism. This is an ironic twist for republican administrations.

McCarran-Ferguson protection the state's insurance rehabilitation and liquidation statutes would amount to a declaration that *Pireno* and *Royal Drug* overruled *National Securities.* Further, it would be directly contrary to the respective holdings of each of those decisions, as shown above. Such a result is unwarranted, particularly on the facts of this case.[9]

C. Historically, Liquidation Schemes Have Been The Exclusive Province Of The States

Even before passage of the Act, state insurance receivership were viewed as the domain of the states, not to be interfered with at the federal level. *See, e.g., Holley v. General Am. Life Ins. Co.,* 101 F.2d 172 (8th Cir.), *cert. denied,* 307 U.S. 619 (1939). *Holley* was a suit to set aside a disposition of assets of an insolvent Missouri insurer, for the appointment of a receiver by the federal court, and for an accounting under its direction and control. The *Holley* court did not entertain the federal involvement in the Missouri liquidation. Instead, it observed:

> *It seems so plain to us that the complainant and the intervener are seeking the interference of the federal court in a matter within the exclusive jurisdiction and control of the state court of Missouri . . . That court not only had jurisdiction, but it had exclusive jurisdiction (citing, Lion Bonding & Surety Co. v. Karatz, 262 U.S. 77 (1923)). It was for that court to determine what the statutes of Missouri permitted or required with respect to the disposition of the trust estate . . .*

* * *

[9] Arguably, this whole issue can be avoided by treating Petitioner as a policyholder. Petitioner does not appear to argue that as a policyholder it should be treated more favorably than other policyholders. *Petitioner's Brief* at 11 n.4.

> *Moreover, it is the established rule that the liquidation of a domestic insurance company under the laws of the state of its domicile, where such laws furnish a comprehensive method of the winding up of its affairs by an officer of the state under the jurisdiction of a court of the state, cannot be interfered with by a federal court (citing, Lion Bonding & Surety Co. v. Karatz, 262 U.S. 77 (1923)).*

Id. at 174.

Petitioner seeks to avoid this history primarily through its reliance on the decision in *United States v. Knott,* 298 U.S. 544, (1936). The Petitioner holds this decision out for the proposition that, historically, the federal priority statute preempted the priorities of state liquidation schemes. It asserts that even if the Act was designed to "turn back the clock" to pre-*South-Eastern Underwriters, Knott* indicates that the federal priority statute trumped a state priority scheme even before the Act. *Petitioner's Brief at 8, 24-26.* Petitioner's argument in this respect fails for two reasons: first, although *McCarran-Ferguson* certainly sought to reverse the perceived ill-effects of *South-Eastern Underwriters* it does not follow that the only result of the statute's enactment was to restore the law to *exactly* what it was before the case that prompted it. Secondly, Petitioner reads too much into *Knott.*

The effect of *McCarran-Ferguson* is discernable from a review of the plain language of the statute. It left to the states exclusive regulation of insurance ***except*** with respect to federal statutes specifically relating to the business of insurance and certain antitrust statutes. Whatever the law may have been before *South-Eastern Underwriters,* the law after *McCarran-Ferguson* is clear: all aspects of the regulation of insurance are left exclusively to the states ***without regard to the provisions of federal statutes not specifically relating to the business of insurance.*** To that extent, therefore, *Knott* is inapposite.

Nor does *Knott* help in resolving the issue before the Court. The case involved a state law which protected a surety's domestic creditors by giving them a preference over foreign creditors. It did not involve a specialized regulatory priority scheme with policyholders competing against the federal government.

A New Jersey insurance company had been put into receivership in New Jersey. When the liquidation began, there were no unsatisfied judgments against it in Florida, where it also transacted business. 298 U.S. at 544, 545. The receivership court in New Jersey assumed *in rem* jurisdiction over the company assets and the receiver set out to marshal them as the officer of the court. *Id.* The insurance company had deposited securities in Florida as required by law, to satisfy any claims against it. There was no ancillary receivership in Florida. After the start of the liquidation in New Jersey, Florida enacted a law which allowed a Florida court to distribute the insolvent insurance company's assets in that state to Florida creditors. A Florida creditor then began a suit against the insurance company in Florida seeking the assets. The United States intervened to satisfy its claim first.

This Court held that the United States could intervene in the Florida proceeding, and that its claim must be paid first. Important to the decision is the finding that the securities in Florida still belonged to the insurance company. 298 U.S. at 550. The Court stated that if title had been transferred from the company, the United States would not be entitled to priority. While the argument can be made that there had been a transfer of title in *Knott,* that is certainly the case here. The assets of the insurance company are in *custodia legis,* to be administered for the receivership court by the receiver. Title is not in the insurance company, the entity which is the debtor of the government.

The salutary purpose of state insurance receiverships is to treat all policyholders fairly and ratably. The very purpose of a receivership court's order enjoining litigation against the company is to protect the insurance company and its assets from the disruptive assertion of conflicting claims of policyholders and creditors. *Eden Financial Group, Inc. v. Fidelity Bankers Life*

Insurance Company, 778 F. Supp. 278 (E.D. Va. 1991). A receiver's primary duty in rehabilitating the company is to marshal all of the assets of the company in receivership, administering them in accordance with the orders of the receivership court and the provisions of the insurance code. *E.g.*, *Motlow v. Southern Holding & Sec. Corp.*, 95 F.2d 721, 724-725 (8th Cir.), *cert. denied*, 305 U.S. 609 (1938). *See generally* 19A Appleman, Insurance Law and Practice, § 10681 (West 1981).

In short, the receiver holds all of the property and assets of the insurer as a fund for the use and benefit of the policyholders and creditors, to be administered in accordance with the provisions of state law, and the orders of the receivership court. *See, e.g.*, *Sangamon Loan & Trust Co. v. Peoples Sav. & Trust Co.*, 204 Ill. App. 7 (1917); *In re Kinney*, 257 A.D. 496, 14 N.Y.S.2d 11 (1939), *aff'd*, 24 N.E.2d 494 (N.Y. 1939). The receiver is the representative of all policyholders and other creditors and has the duty to administer the assets of the company for the benefit of these policyholders and creditors. *Garris v. Carpenter*, 33 Cal. App. 2d 649, 92 P.2d 688 (1939) (duty of receiver includes duty to administer affairs of insolvent insurers for benefit of creditors, policyholders and the public). As such, the receiver of an insurance company not only represents the company but also represents it policyholders, the beneficiaries under the policies, the company's creditors, and is the representative of the public interest in the enforcement of the state's insurance laws as they apply to the policies of the insurance company. *See English Freight Co. v. Knox*, 180 S.W.2d 633 (Tex. Civ. App. 1944).

In *Clark v. Williard*, 292 U.S. 112 (1934) this Court warned of the danger of "allow[ing] the assets of an insolvent corporation to be torn to pieces at the suit of rival creditors when they could be distributed equally and without sacrifice at the hands of a receiver." This warning is particularly appropriate for insurance companies in receivership, and warrants rejection of Petitioner's attempt to elevate its position through the use of the *Federal Priority Statute*. The United States is making a claim on assets owned by the court for the benefit of creditors of the

insurance company. Accordingly, under the rationale of *Knott*, the priority statute does not apply. This is the essence of the holding in *Conway v. Imperial Life Ins. Co.*, 21 So. 2d 151 (La. 1945).

In *Conway*, the Imperial Life Insurance Company had deposited approximately $45,000 with the State Treasurer to enable it to qualify to conduct an insurance business in Louisiana. The Louisiana statute provided that the bond was to be held in trust for the benefit and protection of the company's policyholders. Subsequently, Imperial became insolvent, and a receiver was appointed. The receiver filed a table of debts, listing the United States as an ordinary creditor concerning certain taxes. The United States claimed that it was entitled to priority under the *Federal Priority Statute*. The trial court found against the United States, which was upheld on appeal.

On appeal, the United States argued that *Knott* controlled the decision. The Louisiana Supreme Court, however, distinguished *Knott* on two grounds, one of which is relevant here. The Court noted that the statute specifically provided that the bond was to be held in trust for the use and benefit of the policyholders, whereas the Florida statute concerned in *Knott* contained no such express language. The Court reasoned that the very purpose of the Louisiana law, the protection of policyholders, must be effectuated, and thus, "the claim of the policyholders to the fund in question must prevail over the claim of the United States."

In the context of the present case, where the receivership court and the receiver are holding the assets of the insolvent insurance company in trust for the protection of policyholders and creditors, it is unfair and inappropriate to violate that trust by allowing the federal government a preference.

D. *McCarran-Ferguson* Precludes Application Of The *Federal Priority Statute, 31 U.S.C. § 3713* To A Liquidation Proceeding

Congress intended for the states to regulate the insurance industry in the absence of specific federal legislation. The liquidation of an insurance company is an integral part of a state's regulation. Because the *Federal Priority Statute* is not a specific act directed toward the regulation of insurance, it cannot supplant the efforts of the state. Nothing in the *Federal Priority Statute* indicates that Congress intended that it specifically relate to the business of insurance. In fact, no mention of insurance is made. Congress could have wholly or partially shielded the *Federal Priority Statute* from the effect of the Act if that had been its desire, as it did with the *Sherman Act*, the *Clayton Act*, the *Federal Trade Commission Act*, the *Robinson-Patman Act*, the *National Labor Relations Act*, the *Fair Labor Standards Act*, and the *Merchant Marine Act. See* 15 U.S.C. §§ 1012-1014. The *Federal Priority Statute* has been in existence and actively in use since 1797. Thus, Congress was well aware of its presence and could have provided for it to trump the Act if it had so intended. Because it did not and because a liquidation is "the business of insurance," the supremacy of state law under the Act forbids its application to a state's priority statute in the liquidation of an insurance company. To allow the federal government to assert a priority pursuant to the statute would allow for the very federal interference that Congress intended to prevent.

Conclusion

The relationship between the policyholder and the insurer is of paramount significance in a liquidation proceeding where the efforts of State authorities are directed at preserving assets for the protection of the policyholders and the public. To allow the federal government to assert its priority statute would create the very real threat that control of the states' insurance liquidations would be removed from the hands of the proper state authorities and add chaos to a situation begging for stability.

Moreover, the salutary purpose of state insurance liquidations, of treating all policyholders and creditors fairly and ratably, would be circumvented if the Department of the Treasury were allowed to have its claim adjudicated in a manner inconsistent with the rights and claims of other claimants and policyholders. If the Court sustains the federal government's priority claim, it will start the dismantling of the entire state regulatory insurance scheme at the expense of policyholders, and defeat the fundamental objective of the *McCarran-Ferguson Act.* Congress expressly directed that the states should wholly regulate insurance. In this case the State of Ohio seeks to do exactly that in the most compelling circumstances. Accordingly, the opinion of the United States Court of Appeals for the Sixth Circuit should be affirmed.

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Appendix

15 U.S.C. § 1011

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1012

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.